

**Office of  
The City Attorney  
City of San Diego**

**MEMORANDUM  
MS 59**

**(619) 236-6220**

**DATE:** April 9, 2021  
**TO:** Andy Hanau, City Auditor  
**FROM:** City Attorney  
**SUBJECT:** Legality of Extension of Credit by Development Services Department (DSD) for Deposit Accounts

---

**INTRODUCTION**

The Office of the City Auditor (Auditor) completed an audit of the Development Services Department (DSD) Administration of Deposit Accounts for Development Projects (Audit) in February 2020.<sup>1</sup> One of the Audit findings was that the extension of credit by DSD to allow negative balances on deposit accounts may violate San Diego Charter (Charter) section 93, which prohibits the gift of public funds.

In a memorandum responding to the Audit dated February 5, 2020, DSD agreed with all of the recommendations set forth in the Audit, including recommendations relating to invoicing all deposit accounts with negative balances and suspending work on projects with a negative balance until a positive balance has been re-established.

On January 11, 2021, the Auditor asked our Office whether this practice violates Charter section 93.

**QUESTION PRESENTED**

Does the practice of allowing negative balances on deposit accounts and continuing work violate Charter section 93 which prohibits the gift of public funds?

---

<sup>1</sup> The Audit was recently presented as an informational item at City Council on February 9, 2021. During that presentation, DSD staff stated that they have been invoicing past due deposit accounts and established minimum required balances. They also stated that work is no longer being performed on deposit accounts with negative balances.

## SHORT ANSWER

Our response is based on the specific factual circumstances regarding each deposit account. A Charter section 93 violation will not occur if DSD has identified a legitimate public purpose for allowing a negative balance in a deposit account. However, in the absence of a legitimate public purpose, allowing a negative balance in a particular deposit account constitutes a gift of public funds.

## BACKGROUND

DSD requires customers to set up deposit accounts to recover costs on development projects with highly variable costs. According to the Audit, development projects with highly variable costs would create an inequitable result if charged on a fee basis; some customers would pay far more than the actual cost of processing their project, while others would pay far less. DSD has over 3,700 individual deposit accounts.

A deposit account is created with an initial deposit, which is used to pay for time and materials associated with project reviews and inspections. Pursuant to Department Instruction 9.05 (DI), customers are required to make subsequent deposits to maintain a minimum required balance to pay for all City staff labor charges and other expenses associated with ongoing review.

Once deposit account funds are exhausted, the DI requires the suspension of all work on projects until a positive balance has been re-established sufficient to take the project to completion or to meet the minimum balance required per the deposit schedule, although exceptions to the rule are allowed. It also specifies that “[a]ll exceptions to this requirement must be approved by the Development Services Director. Approval should be in writing or via e-mail with a copy to the project file.”<sup>2</sup>

According to the Audit, DSD permits its project managers to use discretion when setting the minimum required balance on a deposit account. The Audit found that this discretion and the absence of controls had resulted in over 60 percent of deposit accounts having a minimum required balance improperly set at zero. As a result, deposit accounts frequently fell into deficit.

---

<sup>2</sup> The DI also makes clear that “[t]he City of San Diego City Charter, Article VII, Section 93 prohibits the granting of credit by the City of San Diego. The continued work effort by City staff on deposit accounts with a deficit balance is considered granting credit.” (Internal quotations omitted).

## ANALYSIS

### **TO AVOID A CHARTER SECTION 93 VIOLATION, THE CITY MAY NOT PERFORM WORK ON A PROJECT THAT HAS A NEGATIVE BALANCE IN ITS DEPOSIT ACCOUNT UNLESS THE CITY RECEIVES ADEQUATE COMPENSATION OR IDENTIFIES A PUBLIC PURPOSE**

Charter section 93 prohibits the giving or loaning of “credit . . . to or in the aid of any individual, association or corporation; except that suitable provision may be made for the aid and support of the poor.” This Office has previously opined that this provision is similar to the prohibition in Article XVI, section 6 of the California Constitution<sup>3</sup> on the gift of public funds so the cases interpreting that constitutional provision are relevant in interpreting the Charter provision. *See* 1979 Op. City Att’y 8 (79-2; Mar. 2, 1979); 1979 City Att’y MOL 168 (Sept. 4, 1979); 1952 Op. City Att’y 23 (Feb. 27, 1952). Typically, a public purpose is established by the legislative body to justify the use of public resources in a specified manner. *See City & County of San Francisco v. Patterson*, 202 Cal. App. 3d 95, 103-04 (1988).

The prohibition against gifts of public funds does not preclude the use of City resources for public purposes, even if a private person incidentally benefits. *Redevelopment Agency of the City of San Pablo v. Shepard*, 75 Cal. App. 3d 453, 457 (1977); *Schettler v. County of Santa Clara*, 74 Cal. App. 3d 990, 1003 (1977). Where the legislative body makes a determination of public purpose, the concept is liberally construed and the legislative action is upheld unless it is wholly arbitrary. *Mannheim v. Superior Court*, 3 Cal. 3d 678, 691 (1970); *Community Memorial Hosp. v. County of Ventura*, 50 Cal. App. 4th 199, 207 (1996).<sup>4</sup> In determining whether a public purpose exists, only the legal propriety of the expenditure should be examined, not economic or governmental wisdom. *See City of Oakland v. Oakland Raiders*, 32 Cal. 3d 60, 73 (1982).

An expenditure of public funds that benefits a private party constitutes an impermissible gift if the public agency does not receive adequate consideration in exchange or if the expenditure does not serve a public purpose. 2011 City Att’y Report 17 (11-17; Apr. 7, 2011), referencing *People v. City of Long Beach*, 51 Cal. 2d 875, 881-83 (1959); *California Sch. Employees Assn. v. Sunnyvale Elementary Sch. Dist.*, 36 Cal. App. 3d 46, 59 (1973); *Allen v. Hussey*, 101 Cal. App. 2d 457, 473-74 (1950):

[T]he true test is that which requires that the work should be essentially public and for the general good of all the inhabitants of the city. It must not be undertaken merely for gain or for private

---

<sup>3</sup> Since the City of San Diego is a charter city, it derives its powers from its own charter rather than the legislature. Article XVI, Section 6 of the California Constitution is inapplicable because the use of City resources is considered a municipal affair. *Tevis v. City & County of San Francisco*, 43 Cal. 2d 190, 197 (1954); *Mullins v. Henderson*, 75 Cal. App. 2d 117, 132-33 (1946); *Los Angeles Gas & Electric Corp. v. City of Los Angeles*, 188 Cal. 307 (1922).

<sup>4</sup> Under the City’s Charter, a finding of public purpose may be made by the City Council or by City staff. This Office advises committing a public purpose determination to writing.

objects. Gain or loss may incidentally follow, but the purpose must be primarily to satisfy the need, or contribute to the convenience, of the people of the city at large.

*Bank v. Bell*, 62 Cal. App. 320, 330 (1923); *see also Perez v. City of San Jose*, 107 Cal. App. 2d 562, 566 (1951).

As a result, it is important that the City scrutinize the reasoning and factual bases, if any, for the allowance of any negative balance in a deposit account and the continuance of City staff work on those projects. Where there is no legitimate public purpose for such a practice, it would constitute a gift of public funds.<sup>5</sup>

If, for example, the allowance of a negative balance solely benefits a developer in the construction of a purely private project, then it would not be for a public purpose. On the other hand, if a developer was to build affordable housing or a homeless shelter, then it would constitute a legitimate public purpose because courts have found that increasing safe and decent housing as well as the construction of affordable housing to be public purposes, even where the developer also received an incidental benefit. *See Winkelman v. City of Tiburon*, 32 Cal. App. 3d 834, 844-46 (1973); *County of Alameda v. Carleson*, 5 Cal. 3d 730, 745 (1971). There may be other circumstances in which City staff can articulate a legitimate public purpose such as where immediate suspension of work by City staff places the public's safety at risk. We defer to the discretion of City management and the City Council to make such determinations so long as there is information to support the reasonableness of any findings.<sup>6</sup> We further advise that such determinations be made in writing and approved by the DSD Director as described in the DI.

It is our understanding from DSD and Engineering & Capital Projects that City staff has made significant progress in invoicing negative balance deposit accounts and has ceased additional work on such accounts unless public health and safety concerns exist. City staff may wish to formally amend the DI related to negative balances in deposit accounts to more specifically articulate factors in the approval process and why allowing negative balances in certain additional situations would serve a legitimate public purpose.

---

<sup>5</sup> The Auditor has also asked whether there is a bona fide contract between the City and individual deposit account customers that would allow DSD's practice because the provision of adequate consideration would address the concern about gift of public funds. *See Winkelman*, 32 Cal. App. 3d at 845. This Office and DSD staff we spoke with are not aware of any such contract and the creation of a deposit account without more would not constitute a contract.

<sup>6</sup> For example, it is our understanding that Engineering & Capital Projects engineers will continue to inspect improvements or other construction done in the public right-of-way associated with development projects even when deposit accounts for these development projects have a negative balance in order to ensure that such improvements and construction are done properly and the public is not endangered. In addition, City staff may need to continue to perform work on a particular development permit application to avoid the application from becoming deemed completed or deemed approved simply by the City failing to meet specific timeframes for making a determination under the Permit Streamlining Act. *See* Cal. Gov't Code §§ 65943, 65950, and 65952.

